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April 7, 2008

Board of Governors of the Federal Reserve
Attention: Jennifer J. Johnson, Secretary
20th Street and Constitution Avenue, N.W.
Washington, D.C. 20551

Re: Comment of Massachusetts Attorney General Martha Coakley concerning Amendments to Regulation Z, 12 C.F.R. Part 226

Dear Chairman Bernanke and the Board of Governors:

Thank you for the opportunity to comment on the proposed Amendments to Regulation Z under the Truth in Lending Act.

Federal, state and local authorities are now acutely aware that unfair and deceptive lending practices flourished from 2004 through 2007. We now know that an unstable mortgage financing boom was in large part fueled by: (i) excessively risky loan products offered by undercapitalized lenders who focused on sales volume, indifferent to loan performance beyond a very short time period, (ii) origination of these unsound loan products through false advertising, high pressure sales techniques, and misrepresentations by mortgage brokers or loan originators who were incented to sell risky products instead of sustainable loans; and (iii) the sale and securitization of those unsound loans by America's most sophisticated financial institutions. The nation is now witnessing the devastating impact of a few years worth of unbridled greed and the suspension of basic economic realities (e.g., that home valuations fluctuate over time and that sound underwriting requires lenders to document and analyze a borrower's ability to repay over the life of the loan). As the government, we collectively have an obligation to both demand accountability for the serious public harm that has resulted, and ensure, to the extent possible, that the unfair and deceptive lending conduct does not occur in the future.

State and local authorities will be struggling to overcome the deep impact of the resulting foreclosure crisis for years to come. As the developments of the last year have shown, the federal government's laissez-faire approach to mortgage lending regulation led to widespread fraud and abuse in the subprime market and, regrettably, serious public harm.

Although recent experience suggests that the Federal Reserve Board's ("the Board") regulatory amendments may be overdue, the proposed regulations certainly should prove helpful to prevent a future mortgage financing or foreclosure crisis. Given the volume of foreclosures underway, we applaud the Board's first steps for much-needed regulation of the loan servicing industry. It is also critical that the Federal Financial Regulatory Agencies exercise their full visitorial and regulatory powers over servicers to ameliorate the foreclosure crisis by restraining all abusive servicing practices. While this comment suggests ways to improve the regulation, I urge the Board to enact and implement the new rules promptly, and vigorously enforce the regulations to guard against future misconduct and the corresponding public harm.

This Comment first describes my office's recent experience in regulating mortgage lenders and mortgage brokers under the Massachusetts Consumer Protection Act, in hopes that our experience and analysis will prove useful to the federal government as it tackles many of the same issues. The Comment then provides suggestions to increase the effectiveness of the proposed TILA regulations. Namely, I urge the Board to:

- Extend the scope of certain new protections—the ability to pay requirement and the restriction on so-called "stated income" loans—to all mortgage loans, not just the newly defined "higher-cost" loans.
- Supplement the new restriction on mortgage broker compensation, which requires a prior written agreement with the borrower on broker compensation, to include a substantive prohibition on an unfair conflict of interest between the broker's compensation and the borrower's interest.
- Address the critical concern of borrower steering, price gouging, and borrower discrimination, through a new prohibition like the one adopted in Massachusetts.
- Bolster the requirements of loan servicers to guard against unnecessary foreclosures, and use the Board's other powers to help stem the tide of foreclosures by ensuring that servicers achieve reasonable loan modifications.
- Maintain a strict interpretation of its proposed standards for "clear and conspicuous" and "equal prominence," to guard against a repeat of widespread false advertising of loan products.

The Comment also provides additional responses to several of the specific inquiries posed by the Board in its discussion of proposed regulations.

I. The Massachusetts Attorney General's Regulatory and Enforcement Experience Concerning Unfair and Deceptive Lending Practices

Since I became Massachusetts Attorney General in January 2007, one of my top priorities, and an intense focus of my office's resources, has been seeking accountability for lending misconduct and taking appropriate steps to ensure such conduct is not repeated in the future. Two principal aspects of our efforts have been improved regulations and necessary enforcement actions, and both offer guidance to the Board's current proposal to regulate mortgage lenders and brokers.

940 C.M.R. 8.00: *Regulations under the Massachusetts Consumer Protection Act governing Mortgage Lenders and Mortgage Brokers*

In Massachusetts, we recently promulgated amended regulations under our Consumer Protection Act, which govern mortgage lenders and mortgage brokers. A copy of the final regulation, 940 C.M.R. 8.00, is attached as Exhibit 1. As you can see, these regulations address many of the same issues raised in your proposed TILA regulations, and we considered many of the issues on which the Board has solicited comments—false advertising, borrower's ability to pay, abuse of stated income loan products, mortgage broker compensation, and anti-steering. The final regulations, effective January 2, 2008, were the culmination of a six-month process that started with a public comment period, included four statewide public hearings, and included intensive discussions with stakeholders from the banking, mortgage lending, and mortgage broker communities. These final regulations also were shaped by my office's experience investigating and litigating claims against lenders and brokers engaged in predatory loan origination activities. We summarized the results of our investigations, enforcement actions, and regulatory process in a report titled, "The American Dream Shattered." *See* Exhibit 2.

Further, as these regulations were publicized prior to their effective date, my office fielded questions from mortgage lenders and brokers concerning interpretation and implementation. In response, we issued guidance in the form of Questions and Answers issued by the Office of Attorney General. Because the guidance considers implementation questions that may arise with respect to certain of the Board's proposals, a copy is attached as Exhibit 3.

Predatory Lending Enforcement Experience

In addition to improving broker and lender standards in Massachusetts with the consumer protection regulations, we have brought numerous law enforcement actions against mortgage brokers, mortgage lenders and other professionals involved in unfair, deceptive or fraudulent mortgage lending. One of our cases in particular, *Commonwealth v. Fremont Investment & Loan and Fremont General Corp.*, highlights the widespread egregious conduct in the sale of structurally unsound loan products, using deceptive sales practices, all facilitated by the securitization of these loans and their sale to the secondary market. I have attached the Complaint in the *Fremont* case, together with a recent decision by the Massachusetts Superior Court issuing a preliminary injunction that restricts Fremont's ability to foreclose upon loans that the Court defined as structurally or "presumptively unfair." *See* Exhibits 4 and 5 attached.

Based on our regulatory and enforcement experiences, we respectfully suggest changes that would benefit consumers, the economy, and the lending and servicing industry.

II. Comments To Strengthen The Proposed Rules, 12 C.F.R. Part 226

A. The Board Should Extend the Ability to Pay Requirement and the Restriction on "Stated Income" Loans to All Loans, not just "Higher-Priced" Mortgages Loans.

The Proposed Amendments setting forth restrictions on "Higher-Priced Mortgages" are sound consumer protections that should be extended to all mortgage loans securing a consumer's principal dwelling. The proposed restrictions at Sections 226.34(a)(4), 226.34(b)(1) ("Ability to Pay Protection") and 226.35(b)(2) ("Loan Verification Protection") should apply broadly and not be limited to "higher-priced" loans. This is especially true because experience under the high-cost loan definition indicates that lenders will structure their loan products to circumvent the new "higher-priced" definitional trigger. Indeed, the recent foreclosure crisis has shown that lenders will circumvent interest-rate triggers, such as the current Home Ownership and Equity Protection Act ("HOEPA") triggers, to avoid the corresponding consumer protections. Depending on the circumstances, such structuring may well be unlawful. Nevertheless, I fear it is foreseeable that lenders will also attempt to avoid the higher-priced mortgage trigger by keeping interest rates deliberately low, but will increase fees, prepayment penalties or even the principal to account for the rate differential.

As the recent mortgage crisis makes evident, the securitization and wholesale loan sale boom has changed lenders' priorities, warranting the extension of TILA to explicitly cover the unfair practice of originating any loan that a borrower cannot repay. Even if the absence of basic loan underwriting was not as prevalent in the prime market as in the higher-cost market, the principles supporting the ability to pay standard should apply equally to all mortgage loans. Likewise with respect to income verification for a prospective borrower--almost always a crucial element of a borrower's ability to pay—the principle should extend to all mortgage loans. The rule should require all mortgage loans to adhere to these sound requirements. Narrow exceptions may be authorized for the rare circumstances where these principles are not relevant, such as high-income self-employed persons or high-asset borrowers. Broad application of these two rules should be favored over limiting the application of these requirements only to "higher-priced" loans.

In Massachusetts, we recently amended the Massachusetts mortgage broker/lender regulations to include ability to pay and income verification protections for all loans. We believe that our approach is sound, fair, and prudent, and we encourage the Board to do the same.

Borrower's Ability to Pay

Massachusetts regulation 940 C.M.R. 8.06(15) provides that it is an unfair or deceptive act or practice for a mortgage broker or mortgage lender to arrange a loan, unless the mortgage broker or mortgage lender reasonably believes the borrower can repay the loan, using an analysis similar to the proposed Amendment. In contrast to the Board's proposed Ability to Pay Protection, however, the Massachusetts regulation applies to all loans securing one-to-four family residential properties that are primarily for personal, family or household purposes.

The Board, Federal Deposit Insurance Corporation, Office of Comptroller of Currency ("OCC"), and Office of Thrift Supervision (collectively, "Federal Financial Regulatory Agencies") have long viewed lending against the collateral without regard for a borrower's repayment ability for a mortgage loan securing a borrower's principal dwelling as predatory and abusive. For example, in January 31, 2001, the Federal Financial Regulatory Agencies specified that predatory and abusive lending occurs when a lender originates a loan to a borrower who cannot repay the loan from sources other than the collateral pledged, *i.e.*, the home.[1] The OCC reiterated this standard in 2003 in an Advisory Letter issued by the Deputy Comptroller for Currency, which was titled "Guidelines for National Banks to Guard Against Predatory and Abusive Lending Practices." Specifically, the OCC stated that:

> a fundamental characteristic of predatory lending is the aggressive marketing of credit to prospective borrowers who simply cannot afford the credit on the terms being offered. Typically, such credit is underwritten predominantly on the basis of the liquidation value of the collateral, without regard to the borrower's ability to service and repay the loan according to its terms absent resorting to that collateral. This abusive practice leads to "equity stripping." When a loan has been made based on the foreclosure value of the collateral, rather than on a determination that the borrower has the capacity to make the scheduled payments under the terms of the loan, based on the borrower's current and expected income, current obligations, employment status, and other relevant financial resources, the lender is effectively counting on its ability to seize the borrower's equity in the collateral to satisfy the obligation and to recover the typically high fees associated with such credit. Not surprisingly, such credits experience foreclosure rates higher than the norm.[2]

The proposed Amendment regarding the Ability to Pay Protection should reinforce, rather than retreat from, this long-standing principle of fairness. It is anomalous for the Board to imply that such prohibitions only protect borrowers with higher-priced

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[1] "Expanded Guidance For Subprime Lending Programs," p. 10, 11, Board of Governors of the Fed. Reserve System, FDIC, Office of the Comptroller of Currency, and Office of Thrift Supervision (hereafter "Federal Financial Agencies") (January 31, 2001) available at: http://www.federalreserve.gov/boarddocs/srletters/2001/sr0104a1.pdf.

[2] Office of Comptroller of Currency, Advisory Letter 2003-2, pp. 3 (OCC, the national bank regulator, warned its lenders that the inadequate disclosure of the true costs, risks, and appropriateness of the loan transactions may be potentially abusive lending practices). Indeed, a Massachusetts Superior Court in Suffolk County looked to this Guidance and Advisory Letter in finding that Fremont Investment & Loan had "more than fair warning of the dangers posed by [its presumptively unfair loans]." Exh. 5, Findings of Fact and Conclusions of Law on Plaintiff's Motion for a Preliminary Injunction, J. Ralph D. Gants, *Commonwealth v. Fremont Investment & Loan et al.*, C.A. No. 07-4373-BLS1, p. 23 (Suffolk Sup. Ct. Feb. 25, 2008).

mortgages where it has prudently and consistently prohibited this behavior with respect to all mortgages securing a borrower's principal dwelling.

Further, a Board study indicates that a significant number of Massachusetts borrowers with prime mortgages were refinanced into subprime mortgages, culminating in yet another subprime refinancing and then foreclosure.[3] In addition, the evidence is mounting that prime borrowers, particularly minority prime borrowers, were steered into subprime mortgages. Thus, there is a significant need for protection of all borrowers, not simply those borrowers that fit a traditional subprime profile. All borrowers, and all of the American public, deserve the protection of the Amendment, not only those with the misfortune to be sold higher-priced loans.

Verification of Income and Assets

We believe the Verification of Income and Assets Protection (12 C.F.R. 226.35) should also be extended to all mortgages securing a borrower's principal dwelling. As federal regulators know, so-called "stated income" or "no doc/low doc" loan products originally were designed to be offered to a small segment of borrowers, such as high-asset individuals or those with income that was significant but not reflected by a standard reference to W-2's or even tax returns. The explosion in stated income loans from 2004 to 2006, with the predictable abuse that accompanied it, defied reasonable lending standards, business sense, and common sense. The Board should demand that mortgage lenders return to reality-based lending. A broadly applicable rule should generally prohibit use of these loan products for all loans, with limited exceptions originally envisioned when these products were designed, not just higher-priced mortgage loans. The Board then can provide flexibility to lenders on two points: (i) providing flexibility with respect to exactly how lenders document or verify income; and (ii) permitting limited use of low documentation products in circumstances that do not present excessive risk of abuse or default.

In Massachusetts, our office sought to strike this balance with respect to these oft-abused loan products. Our regulation, 940 C.M.R. 8.06(16), does not ban no- or low-doc products, but it requires, for nearly all such loans: (i) that, as a minimum verification step, lenders require the borrower to sign a written statement identifying their income and source; and (ii) a disclosure (if applicable) explaining that the loan costs more because of the no- or low-doc feature. The regulation also prohibits lenders or brokers from ignoring information they have received, in favor of a borrower's higher income representation. Finally, in order to address lenders' expressed desire to offer certain "streamlined" loan products that in no way rely on borrower income (e.g., for high asset borrowers or very low LTV borrowers), we permitted flexibility for "No Income Loan Products," as defined in 940 C.M.R. 8.03.

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[3]Approximately 30 percent of the 2006 and 2007 foreclosures in Massachusetts were traced to homeowners who used a subprime mortgage to purchase their house. However, almost 44 percent of the foreclosures were of homeowners whose last mortgage was originated by a subprime lender. Of this 44 percent, approximately 60 percent initially financed their purchase with a mortgage from a prime lender. http://www.bos.frb.org/economic/wp/wp2007/wp0715.pdf

Our regulation restricting the use of stated income loans provides:

> (16) It is an unfair or deceptive act or practice for a mortgage broker or lender to process or make a mortgage loan without documentation to verify the borrower's income (a so-called "no documentation," "no doc," "stated income" or "limited documentation" loan) unless the broker or lender, as applicable, first provides a written document to the borrower, which must be signed by the borrower in advance of the closing, and which: a) identifies the borrower's income and the source of the income; and b) provides detailed information, if true, that by applying for a mortgage loan on a no- or limited documentation basis, the consumer will pay a higher interest rate or increased charges, or have less favorable terms for the mortgage loan (including information concerning the precise increase in interest rate, charges, or the nature of the less favorable terms). Provided, however, that if a mortgage broker or lender arranges or makes a mortgage loan using a No Income Loan Product (as defined herein), which loans shall remain subject to Section 8.06(15), the requirement in clause (a) of the preceding sentence shall not apply. It is an unfair or deceptive act or practice for a mortgage lender or broker to process or make a mortgage loan on a no- or limited documentation basis if the stated income provided by the borrower with respect to the no- or limited documentation loan contradicts information previously obtained by the broker or lender with respect to that borrower in connection with the same proposed loan, absent a documented change in circumstances or other documented explanation for the discrepancy between the prior information and latter income representation. Notwithstanding the foregoing, it shall be an unfair or deceptive act or practice for a mortgage lender to underwrite or close a loan without first verifying the employment or income of the borrower when the amount of the income stated is not reasonable for the actual employment status or experience of the borrower known to the lender, or when the borrower's stated employment or stated income is not reasonable in light of the borrower's circumstances known to the lender.

In contrast to the proposed Verification of Income and Assets Protection, this Massachusetts regulation applies to all loans securing one-to-four family residential properties that are primarily for personal, family or household purposes. We urge the Board to expand its restriction on Stated Income loans beyond only "higher-priced" loans.

B. <u>Effective Regulation of Mortgage Broker Compensation Must Go Beyond Requiring a Prior Written Agreement. The Rules Should Prohibit Conflicts of Interest Between a Broker's Compensation and the Client's Interest.</u>

In the new proposed rule at 12 C.F.R. 226.36(a), the Board proposes to address mortgage broker compensation by prohibiting creditors from paying brokers any money that exceeds the amount that broker and borrower agreed, in a prior written agreement, would be broker's maximum compensation. That prior written agreement also would disclose that borrowers are responsible for payments even if they are paid by lenders and that lender payments may influence broker to offer products that are not in the borrower's interest or are not as favorable as may be available. The proposal essentially adopts a disclosure approach to one of the fundamental problems that drove subprime origination misconduct: lender financial incentives that drive brokers to arrange loans that are harmful to borrowers.

We recommend that, in addition to requiring a prior written agreement, the Board adopt a substantive prohibition against broker compensation that presents an unfair conflict between the interests of broker and borrower.

The Board's discussion of mortgage broker compensation (Section VIII.A) presents the correct and compelling case for regulating creditor payments to mortgage brokers: the market has failed to restrict, in any meaningful way, the amount or bases for creditor payments to mortgage brokers, including the misuse of Yield Spread Premiums (YSPs). The Board's discussion reinforces the same conclusions my office has reached as a result of investigations, litigation, and our regulatory hearings. Namely:

- Borrowers rarely know in advance of closing that that their broker will be paid a YSP. If they do know, borrowers rarely understand the basis for the YSP—namely, that the YSP and its amount are tied directly to an increase in the borrower's interest rate, and often tied to other risk features or cost features.

- YSPs can incent brokers to originate loans that result in the highest compensation to the mortgage broker, *not* 'the best terms for which the borrower qualifies.'

- Our investigations and litigation indicate, regrettably, that in far too many situations brokers chose to maximize their compensation, with little regard to the impact on the borrower. This reflects a massive gap between borrower perception and the broker's own view of their (lack of) obligation to the borrower. Borrowers generally perceive that the broker will represent the borrower's interest, shop around for good loan terms, and presumably avoiding unnecessary costs. Many brokers do not necessarily acknowledge any duty to their client, formal or informal.

- A general lack of transparency with respect to the relationship between the cost to the borrower of a broker commission and a YSP makes effective comparison shopping very difficult, especially for those borrowers who choose to use brokers.

These realities, all highlighted in the Board's discussion of proposed rule 226.36 (at Part VIII), show that the essential problem with creditor payments to mortgage brokers is that they create a <u>conflict of interest</u>. YSPs inevitably create a potential conflict between the broker's financial interest and the borrower's interest in getting the best loan for which they qualify, thereby significantly contributing to unfair and deceptive loan origination by subprime lenders.[4] "Prior written agreements" or disclosures cannot cure that conflict of interest. The Board should squarely tackle this fundamental conflict by banning compensation that presents an unfair conflict between broker and client.

A written agreement between broker and borrower concerning compensation will not suffice to make the market work or to avoid unconscionable, conflicted compensation from lender to broker, especially given the central role many mortgage brokers have played in originating predatory, unfair and deceptive loans. In order to be meaningful, the borrower must understand the material terms of any compensation agreement. In many instances, meaningful understanding will not follow from explanation by mortgage brokers, whose interests will be served by a favorable (probably simplistic) explanation of how the broker has helped the borrower and how the broker will be compensated. In other words, the existence of a form, without any safeguard against conflict, will not necessarily yield the level of borrower comprehension required to enable the market to work.

Moreover, no compliance mechanism can reasonably guard against brokers who undermine the contents of the agreement by their verbal explanations and representations. Indeed, this raises a problem familiar to those of us who have investigated and litigated wholesale lenders for unfair and deceptive conduct. In that arena, lenders disclaim responsibility, contending that brokers were the persons directly responsible for explaining loan terms to borrowers accurately. In that context, our investigations reveal that brokers and/or loan officers often:

- Disparage loan forms and disclosures and instruct borrowers to ignore them.

- Provide oral assurances that contradict and/or are inconsistent with the loan documents. One common promise is that the lender will refinance the loan before the "teaser" rate expires.

- Ask borrowers to execute blank forms, facilitating application fraud and undermining lending disclosure laws.

- Make false assurances that the rate offered is the best rate available and that the broker has shopped around for the best rate available to the borrower, without disclosing the financial incentives that may be driving the broker's loan selection.

- Fail to disclose fees payable to mortgage brokers for putting consumers into higher-priced loans than those for which they are eligible.

- Offer loan products with terms that are difficult for the consumers to understand and provide the consumers with no appreciable assistance.[5]

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[4] *See* Exhibit 4 (complaint against Fremont Investment & Loan), at pp. 12-16; see also Exh. 2, at pp. 16-18.
[5] See Exhibit 2, at pp. 5-7, 18-21. Lenders' claims of ignorance about, or disclaiming responsibility for, this conduct usually are not supported by the evidence.

These experiences counsel strongly against relying on brokers to explain their compensation from lenders and demonstrate that this issue deserves a substantive prohibition. This same issue received intense scrutiny in Massachusetts during our regulatory process and during implementation of our regulations. Our regulation on this point, 940 C.M.R. 8.06(17), provides:

> It is an unfair or deceptive act or practice for a mortgage broker to process, make or arrange a loan that is not in the borrower's interest. Where the financial interest of a mortgage broker conflicts with the interests of the borrower (for example, where the broker's compensation will increase directly or indirectly if the borrower obtains a loan with higher interest rates, increased charges or less favorable terms than those for which a borrower would otherwise qualify), the broker shall disclose the conflict and shall not proceed to process, make or arrange the loan so long as such a conflict exists. It is an unfair or deceptive act or practice for a mortgage broker to disclaim the duty established by this subsection (17) in a written contract or to assert in oral representations that a broker does not have such a duty in communications with the borrower.

This regulation, we have made clear, does not ban YSPs. It bans YSPs and other compensation that unfairly conflict with a borrower's interest. Our guidance on this topic offers several examples. *See* Exhibit 3 (Guidance, Dec. 18, 2007). Since January 2, 2008, brokers and lenders in Massachusetts have operated under the new rule and we believe that consumers are well protected by the prohibition against fees charged that contradict the borrower's interest. We encourage the Board to adopt a similar, if not same approach, in order to ensure fairness and transparency, and to prevent future abuses.

C. <u>The Board Should Adopt a Rule to Address Steering, Price Gouging, and Borrower Discrimination</u>.

In Section IX.B., the Board explains that it declines to issue a rule designed to prevent steering, but suggests that its Ability to Pay and Mortgage Broker Compensation provisions may serve to combat "steering." I urge the Board to directly address the problem of lenders steering borrowers into loans that involve costs that are not justified by the borrower's bona fide credit and other qualification criteria.

Whether referred to as "steering" or, perhaps more accurately, "price gouging," subprime lender investigations by my office and other Attorneys General disclose a troubling dynamic when a borrower approaches certain lenders for a loan. In particular, for some loan originators the starting point of the negotiation is not "what loan products does this borrower qualify for?" but instead: "How much money can I (as originator) and my lender make off this borrower." From that disturbing starting point, the originator concedes only what is necessary to close a deal for that borrower. Lack of borrower financial sophistication, together with deceptive sales practices, often led to origination of loans, the terms and costs of which bore little relation to the borrower's actual qualifications.

Some lenders may contend that they should be entitled to charge whatever "the market" will bear, but this should not be condoned and no reasonable lender should expect that business model to be endorsed by the government. Primarily, given the failure of lenders and brokers to provide information sufficient to allow borrowers to make informed decisions with regard to selection of loan originators and loan products (as discussed above), the "market" fails to resemble a typical consumer market where informed consumers can make educated decisions with regard to price and terms of loan products. Notably, this "market" approach is inconsistent with lender advertising, which typically promises qualification-based lending, *not* unfettered steering or gouging. Further, the recent past shows that this approach – an approach based not on lender risk and costs, but on taking maximum advantage of unsophisticated homeowners – can have devastating consequences. The potential disparate impact on communities with many first-time homebuyers, borrowers with less formal education and non-English speaking borrowers, warrants intervention. Finally, would-be borrowers' lack of confidence in loan originators will only exacerbate the dismal housing market, which will further the devastating effects of the housing market on the overall economy.

The Board should adopt a rule that prevents steering and price gouging in the mortgage lending arena. I recommend the regulation we have adopted here in Massachusetts, 940 C.M.R. 8.06(18):

> It is an unfair or deceptive act or practice for a mortgage lender (a) to use a pricing model for its mortgage loans which treats borrowers with similar credit criteria and bona fide qualification criteria differently; or (b) to make a mortgage loan when any or all of the cost features of the mortgage loan are based on criteria other than the borrower's credit and other bona fide qualification criteria. For purposes of this paragraph, "bona fide qualification criteria" shall mean those criteria that a lender, pursuant to written loan underwriting or origination policies, takes into account in determining whether to extend a mortgage loan, including by way of example, income, assets, credit history, credit score, income-to-debt ratios or loan-to-value ratios. For purposes of sub-paragraph (b), the term "cost features" shall include, but not be limited to, the interest rate; the index; margin; and other adjustment features if the interest rate is adjustable; points; and prepayment penalties.

Responsible lenders already have, and already enforce, loan pricing policies that conform to this standard, in effect in Massachusetts since January 2, 2008. This regulation does not dictate to lenders what "bona fide qualification criteria" may be taken into account; it simply demands that loan pricing be tied to those written criteria, in order to guard against steering and gouging. I urge the Board to adopt a similar rule.

D. The Board Should Demand that Loan Servicers Take Steps to Prevent, And Not Facilitate, Foreclosures that Are Avoidable.

I commend the Board for including in this proposed rule consumer protections against loan servicer misconduct (12 C.F.R. 226.36(d)). While most of the proposed rules serve to guard against the next era of unfair and deceptive lending conduct, the servicer rule is uniquely able to help borrowers now, in avoiding unnecessary foreclosures. The Board is correct to highlight the critical role of loan servicers in avoiding unnecessary foreclosures, and each of the new obligations in Section 226.36(d) will serve that goal.

In addition, whether through additional rules or through its relationship with lenders, we request that the Federal Financial Regulatory Agencies heighten loan-servicing protections for consumers. The State Foreclosure Prevention Task Force, on which I serve with ten other Attorneys General and state banking supervisors, recently published an Analysis of Subprime Mortgage Servicing Performance. *See* Exhibit 6. This Report highlighted the urgent need for more loan modifications, a need that Chairman Bernanke recently echoed. Although lenders and servicers have publicly agreed that a large number of loan modifications are necessary to avoid unnecessary foreclosures, my office continues to witness a vast disconnect between those public statements and the actual treatment of delinquent borrowers seeking a workout option. Many borrowers seek a loan modification to achieve loan affordability, but are only offered unrealistic repayment or forbearance proposals. Some borrowers should qualify for a loan modification but cannot reach a live person capable of discussing loss mitigation. Some find that they are being held responsible for fees and charges which they do not understand, and for which they cannot obtain an itemization. The American public and the economy will suffer further from servicing abuses, if servicers continue to gouge borrowers through unfair fees, unresponsive servicers, and unrealistic loss mitigation solutions, all of which lead to unnecessary foreclosures.

The Federal Financial Regulatory Agencies should exercise their full visitorial and regulatory powers to require meaningful loan workouts where such a workout, in light of the borrower's ability to pay and their home's current market value, would be the prudent, safe and sound option rather than foreclosure. Likewise, the Agencies must ensure that consumers are receiving meaningful loan modifications based on prudent underwriting principles, so as not to create multiple waves of foreclosures over the next decade.

E. The Board Should Maintain Strict Standards for "Clear and Conspicuous" and "Equal Prominence," in its Advertising Regulations.

I commend the Board for proposing rules to combat false advertising in the mortgage lending arena (12 C.F.R. 226.16 & 226.24, discussed in Part X of proposed rule). I urge the Board to maintain its strict approach to requiring "clear and conspicuous" disclosures, especially through its "equal prominence and close proximity" standard.

The Board has correctly identified the broad harmful impact of misleading advertising. Deceptive advertising—whether through direct mail, print, TV/radio, or internet—often serves as the borrower's point of entry to a predatory loan. In recent years, unscrupulous lenders and brokers have falsely advertised introductory "teaser" rates, failed to disclose critical terms, and plainly misstated terms such as interest rates and monthly payments. These ads also serve as the "bait" in common bait and switch tactics, especially with respect to switching borrowers from true fixed to adjustable rate loans. To guard against misleading advertising while preserving the lender's right to advertise actual terms, the Board's definitions for "clear and conspicuous" and "equal prominence and close proximity" will play a huge role in whether the regulations serve as a meaningful consumer protection, or alternatively, are subject to manipulation by unscrupulous lenders. My experience regulating advertising indicates that some businesses will urge the Board to provide greater "flexibility." Quite simply, an advertisement of a low teaser rate is deceptive if the post-introductory terms and costs are not featured in equal prominence and close proximity. I urge the Board to decline any efforts to weaken those important standards.

III. Conclusion

Having dedicated significant resources of my office to combating predatory lending and its ill effects, I am pleased that the Board is also now dedicated to establishing meaningful standards for lender and broker conduct. I urge the Board to make the proposed rules more meaningful by extending their scope and adopting the additional substantive standards described in this Comment. Many of the other proposed rules that I have not specifically mentioned will provide helpful consumer protection standards—including the rule against appraisal fraud or coercion, further limits on prepayment penalties, and the advertising standards. I urge the Board to promulgate all of these standards in a timely manner.

Finally, I recognize that combating predatory lending and protecting the public from its aftermath will take the full attention and resources of federal, state and local authorities. I sincerely hope that all federal authorities, State Attorneys General and other State regulators will work in collaboration to leverage our resources and serve the public interest. I know that will continue to be my approach. If I can provide any further information or assistance related to the Board's proposed TILA rules, or any other of our common objectives, please contact me.

Cordially,

Martha Coakley

Martha Coakley
Attorney General
Commonwealth of Massachusetts

cc: U.S. Senator Edward Kennedy
U.S. Senator John Kerry
U.S. Representative Barney Frank
U.S. Representative Edward J. Markey
U.S. Representative John Olver
U.S. Representative Richard Neal
U.S. Representative James P. McGovern
U.S. Representative Niki Tsongas
U.S. Representative John Tierney
U.S. Representative William Delahunt
U.S. Representative Michael Capuano
U.S. Representative Stephen Lynch
Commissioner Steven L. Antonakes, Massachusetts Division of Banks
Members of the State Foreclosure Prevention Working Group (by e-mail)

APPENDIX OF ATTACHMENTS

COMMENT OF ATTORNEY GENERAL MARTHA COAKLEY
TO THE FEDERAL RESERVE BOARD

1. 940 C.M.R. 8.00 *et seq.*: Massachusetts Regulations under the Consumer Protection Act, G.L. c. 93A governing mortgage lenders and mortgage brokers.

2. "American Dream Shattered," a Report by Attorney General Martha Coakley (October 7, 2007).

3. Guidance issued by the Massachusetts Attorney General concerning 940 C.M.R. 8.00 *et seq.* (December 18, 2007).

4. Civil Complaint, *Commonwealth of Massachusetts v. Fremont Investment & Loan and Fremont General Corp.* (October 4, 2007).

5. Findings of Fact and Conclusions of Law on Plaintiff's Motion for a Preliminary Injunction, J. Ralph D. Gants, *Commonwealth v. Fremont Investment & Loan et al.*, C.A. No. 07-4373-BLS1, (Suffolk Sup. Ct. Feb. 25, 2008).

6. State Foreclosure Prevention Working Group, Analysis of Subprime Mortgage Servicing Performance, Data Report No. 1 (February 2008).